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A Tale of Two Professions: The Third-Party Liability of Accountants and Attorneys for Negligent Misrepresentation

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To whom does a professional owe a duty of care when providing professional services?¹ The traditional answer, grounded in principles of contractual privity, is that professionals are liable for negligence to their clients, and perhaps to third-party beneficiaries of the client-professional relationship, but that their noncontractual obligations generally extend no further than a duty not to commit fraud.² In the past two decades, however, courts have become increasingly willing to hold a wide range of professionals liable for their negligence to parties outside the chain of privity.³ The accompanying growth of third-party⁴ lawsuits alleging professional negligence,

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¹ The distinction between "professions" and other occupations seems to reflect the hubris of self-described professionals more than any underlying economic reality. The cases we examine, however, treat professionals—such as accountants, architects, attorneys, and engineers—as a distinct class of persons. We accordingly accede to that practice.

² Note, *Privity Requirement for Attorney Liability to Nonclients*, 4 ST. JOHN'S J.L. COMMENTARY 321, 321 n.1 (1989) (authored by Melinda R. Katz).

³ See *Donnelly Constr. Co. v. Oberg/Hunt/Gilleland*, 139 Ariz. 184, 677 P.2d 1292 (1984) (holding architects liable for professional negligence to foreseeable nonclient victims); *Wolther v. Schaarschmidt*, 738 P.2d 25 (Colo. App. 1986) (holding that a nonclient purchaser had a cause of action for negligent misrepresentation against an engineer who conducted a walk-through investigation of a house).

⁴ For purposes of our analysis, "third parties" are persons who are neither in direct contractual privity nor in some functionally equivalent relationship with the defendant professionals. In particular, we somewhat idiosyncratically treat suits brought by third-party

and in particular alleging negligent misrepresentation by accountants or attorneys, raises serious questions for professionals concerning their legal and ethical obligations to nonclients.

These recent changes in liability standards have not been uniform across professions. Specifically, accountants have thus far seen their liability to third parties for negligent misrepresentation expand far more rapidly than have attorneys.⁵ There are strong indications, however, that the attorneys are making up some ground—no doubt more quickly than they would like. One modern court, in permitting a third-party suit against an architect for negligently preparing engineering site specifications, “expressly disapprove[d] . . . blanket denials of causes of action”⁶ by third parties against professionals in general, with specific reference to suits against attorneys for negligent misrepresentation.⁷ Another court, in finding an accountant answerable to a third party for negligent misrepresentation, declared even more directly that “[w]e doubt the wisdom of continuing to apply different standards for determining the liability of different professionals to third parties.”⁸

These sweeping judicial pronouncements should be of great interest to attorneys. There is good reason to believe that the relatively benign treatment now typically enjoyed by attorneys in third-party lawsuits is primarily, if not entirely, the consequence of an enduring, carefully cultivated image of the lawyer as a faithful fiduciary, zealously guarding his client's interests even at the expense of the broader public. Unsympathetic court statements,⁹ however, may reflect a growing shift in the legal system's perception of the lawyer's professional role. There has definitely been such a change in the perceived professional role of accountants and it has been a major factor in the modern expansion of accountants' third-party liability. If the disparate treatment currently afforded accountants and attorneys in third-party lawsuits is the product of differing role conceptions, and if the legal system's views of lawyers and accountants are starting to converge, a significant expansion of attorney liability may not be far off. Admittedly, similar predictions have been made in

beneficiaries of contracts and, if necessary, suits by intended beneficiaries of wills, as first-party rather than third-party actions. *See infra* note 44.

⁵ *See infra* text accompanying notes 40–74.

⁶ *Donnelly*, 139 Ariz. at 188, 677 P.2d at 1296.

⁷ *See id.* The court in *Donnelly* rejected a prior decision of the Arizona Court of Appeals that declined “to grant a cause of action for [negligent misrepresentation] to an individual who [was] not a client or in privity with the attorney.” *Chalpin v. Brennan*, 114 Ariz. 124, 126, 559 P.2d 680, 682 (1976)).

⁸ *Blue Bell, Inc. v. Peat, Marwick, Mitchell & Co.*, 715 S.W.2d 408, 413 (Tex. Ct. App. 1986).

⁹ *See supra* notes 6–8 and accompanying text.

the past two decades with little success,¹⁰ but more recent legal developments suggest that it is time to examine them anew.¹¹

This Article presents a descriptive and predictive analysis of the third-party liability of accountants and attorneys for negligent misrepresentation.¹² By way of background, Part I describes the activities of each profession that seem most frequently to expose practitioners to third-party claims of negligent misrepresentation, and Part II sketches the various legal standards applied by courts in assessing such claims and the trends in the law that have emerged over the last two decades. Part III provides our substantive analysis in four sections. The first section sets forth the reasons most often advanced by courts for adopting standards that expand the liability of accountants or attorneys beyond the chain of privity. The second section explores whether those reasons portend a narrowing of the existing difference in third-party liability standards that are applied to the two professions. The third section recounts an aborted attempt by the Securities and Exchange Commission in the 1970s to redefine radically the lawyer's role in securities transactions, which holds valuable, if ambiguous, lessons for both attorneys and accountants faced with the prospect of expanding third-party liability. Finally, the fourth section concludes that the thread separating the two professions' third-party tort liability is thin and fraying.¹³ Thus, lawyers should seriously contemplate the possibility that they may be the targets of the next rash of third-party lawsuits against professionals—after the accountants, architects, and engineers have been adequately bashed. As one commentator noted:

Enter a small irony: Actions against accountants are filed by lawyers, who by winning create a climate receptive to the abandonment of privity in claims

¹⁰ See Hilliker, *Attorney Liability to Third Parties: A Look to the Future*, 36 DE PAUL L. REV. 41, 66 (1986); Note, *Public Accountants and Attorneys: Negligence and the Third Party*, 47 NOTRE DAME L. REV. 588, 588 (1972).

¹¹ Or, as Bullwinkle once said to Rocky: "This time for sure!"

¹² While we make occasional references to the liability of other professionals, our study formally encompasses only accountants and attorneys. More significantly, our study is strictly confined to the common-law tort of negligent misrepresentation. See *infra* text accompanying notes 33–34. We do not directly address, for example, the potential liability of professionals for other torts, common-law fraud, or violations of state or federal securities laws.

¹³ We do not discuss whether the thread should be rewoven or allowed to fray further. If we did, we would strongly endorse the traditional privity standard for both accountants and attorneys, in part for reasons that have been well stated elsewhere. See Goldberg, *Accountable Accountants: Is Third-Party Liability Necessary?*, 17 J. LEGAL STUD. 295 (1988); Gossman, *The Fallacy of Expanding Accountants' Liability*, 1988 COLUM. BUS. L. REV. 213; Lawson & Olson, *Caveat Auditor: The Rise of Accountants' Liability*, CLAIMS, Apr. 1990, at 34; Note, *Expanding Legal Malpractice to Nonclient Third Parties—At What Cost?*, 23 COLUM. J.L. & SOC. PROBS. 1 (1989) (authored by Douglas A. Cifu).

against all professionals, themselves included. For although accountants and lawyers sell clients different skills, the services of either, if performed negligently or fraudulently, can work great harm to others.¹⁴

I. HOW ACCOUNTANTS AND ATTORNEYS GET INTO TROUBLE

Accountants and attorneys are often intimately involved in their clients' financial transactions by providing counsel, preparing or assisting in the preparation of documents, and offering opinions on the need for and sufficiency of financial or legal disclosure. The resulting documents and opinions they generate are then frequently distributed, possibly without the professional's knowledge, to third-party creditors and investors. If the circulated material is erroneous or misleading as a result of the professional's negligence, injured third parties who relied on that material¹⁵ may assert a cause of action for negligent misrepresentation against the professional. A brief look at the transactional roles of accountants and attorneys provides a useful framework for examining the emergent pattern of third-party liability for the two professions.

A. *The Transactional Role of Accountants*

For parties contemplating participating in business transactions, knowledge is power. Because companies are not always the most trustworthy sources of financial information about themselves, prospective lenders, investors, or customers will frequently insist upon audited financial statements before dealing with the company.¹⁶ Thus, both to satisfy outside parties and for purposes of their own internal management, companies typically must engage an outside accountant.

¹⁴ Gillers, *Ethics that Bite: Lawyers' Liability to Third Parties*, 13 LITIGATION, Winter 1987, at 8.

¹⁵ We assume throughout this Article that reliance is a necessary element of a negligent misrepresentation claim. See, e.g., *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1131 (5th Cir. 1988) (applying Louisiana law), *cert. denied*, 492 U.S. 918 (1989); *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 322 N.C. 200, 206, 367 S.E.2d 609, 612 (1988).

¹⁶ Regulatory agencies may also demand the production of audited financial statements. For example, the Securities Act of 1933 prohibits a wide range of transactions with respect to a security unless a registration statement has been filed as to such security. 15 U.S.C. § 77(e) (1990). Schedule A of the Act, which regulates the content of most registration statements, requires the inclusion of audited financial information. 15 U.S.C. § 77(e) schedule A (25), (26).

The two most important services provided by the accountant are an audit of the client's accounting books and procedures¹⁷ and the issuance of an opinion discussing whether the client's financial statements have been prepared in accordance with generally accepted accounting principles (GAAP).¹⁸ Although the accountant may be heavily involved in preparing financial statements, the statements themselves, unlike the accountant's opinion concerning them, are formally the representations of the client's management rather than of the accountant.¹⁹

The accounting profession's self-governing body, the American Institute of Certified Public Accountants (AICPA),²⁰ has established a set of generally

¹⁷ Fundamentally, an audit is an examination of a company's financial position, transactions, and internal accounting practices over a specified period of time. It will typically involve a review of representative samples of such important items as a company's cash holdings and accounts receivable, other assets and liabilities, major contracts and documents, minutes of board of directors' meetings, and internal accounting control procedures. See generally Hagen, *Certified Public Accountants' Liability for Malpractice: Effect of Compliance with GAAP and GAAS*, 13 J. CONTEMP. L. 66-67 (1987).

¹⁸ GAAP are guidelines that reflect

the consensus at a particular time as to which economic resources and obligations should be recorded as assets and liabilities by financial accounting, which changes in assets and liabilities should be recorded, when these changes should be recorded, how the assets and liabilities and changes in them should be measured, what information should be disclosed and how it should be disclosed, and which financial statements should be prepared.

3 AICPA PROFESSIONAL STANDARDS AC § 1026.01 (1979).

¹⁹ Although an accountant's principal tasks are auditing and opinion writing, 1 AICPA PROFESSIONAL STANDARDS AU § 110.01 (1989) [hereinafter PROFESSIONAL STANDARDS], public accountants also perform such functions as reviews or compilations of clients' financial statements, tax counseling and compliance work, and management and financial consulting. Judging from the reported decisions, however, these functions rarely give rise to third-party negligent misrepresentation suits. In review engagements, the accountants perform only limited tests and inquiries to provide themselves with "a reasonable basis for expressing limited assurance that there are no material modifications that must be made to the financial statements." 2 *id.* at AR § 100.04. In compilation engagements, accountants limit their responsibility solely to the actual compilation of the financial statements. They do not assert that the financial statements conform to GAAP or that an audit or review of the client's financial books was performed. *Id.* Consequently, in both review and compilation engagements, accountants will make it clear that they did not perform an independent audit, which may render it unreasonable for users of financial statements to place substantial reliance on the accountants' statements. Counseling and financial consulting activities are even less likely to be the subjects of third-party negligent misrepresentation lawsuits.

²⁰ The AICPA is a private organization whose stated objectives are:

accepted auditing standards (GAAS), with which member accountants must comply when conducting audits. Violations of GAAS may result in professional disciplinary actions.²¹ Within the broad parameters established by GAAS, the accountant has substantial discretion in determining the nature of the specific audit steps and tests to be performed.²² The procedures employed must be designed to provide reasonable assurance that material errors and irregularities will be detected. Nonetheless, the auditor is not required actively to search for and locate such errors or fraud.²³ Significantly, however, the auditor must maintain a stance of independence from the client, who is likely to be financially interested in receiving as favorable an audit opinion as possible.²⁴

Although the accountant routinely is exposed to sensitive and confidential financial information concerning the client, the accountant's work product, unlike an attorney's work product, is not protected by common-law evidentiary

[T]o unite certified public accountants in the United States; to promote and maintain high professional standards of practice; to assist in the maintenance of standards for entry to the profession; to promote the interests of CPA's; to develop and improve accounting education; and to encourage cordial relations between CPA's and professional accountants in other countries.

2 *Id.* at BL § 101.01. The AICPA oversees the activities of public accountants in the performance of their duties and is responsible for disciplining members of the profession for not following professional standards.

²¹ In general, GAAS require that accountants have adequate training and proficiency as auditors, that they be independent in the performance of audit duties, and that they conduct those duties with due professional care. *Id.* at AU § 150.02. Statements of auditing standards (SAS), which are detailed interpretations of the GAAS regarding specific features of an audit, are also frequently referred to as GAAS. *See* A. ARENS & J. LOEBBECKE, *AUDITING: AN INTEGRATED APPROACH* 17 (4th ed. 1988).

²²

A typical audit involves five essential steps. First, the auditor must plan the audit Second, the auditor must make a preliminary evaluation of the client's internal accounting control system. Third, the auditor must conduct compliance tests to determine whether that control system is functioning properly. Fourth, the auditor must evaluate the audit program and modify it to conform to the results of the compliance tests. Finally, the auditor must evaluate the information obtained and issue a report (an "opinion") stating whether the client's financial statements accurately reflect the financial position of the enterprise.

Gossman, *supra* note 13, at 213.

²³ *See* PROFESSIONAL STANDARDS, *supra* note 19, at AU § 316.

²⁴ *Id.* at AU § 220.

privileges.²⁵ This gap has been partially closed by statutes, which protect accountant-client communications “in perhaps a third of the states.”²⁶

If the auditor has received all needed data and has concluded that the financial statements fairly conform with GAAP, the auditor will issue a “clean” or “unqualified” audit opinion.²⁷ A clean audit opinion from a reputable public accounting firm can be a valuable asset to a firm and a burdensome liability to the accountant. If the audit report is clean but a plaintiff’s attorney can credibly argue that the financial statements are incomplete or misleading, the accountant becomes a potential target of a negligent misrepresentation suit by disgruntled creditors or investors who obtained and relied upon the information.

B. *The Transactional Role of Attorneys*

Like accountants, attorneys often are deeply involved in their clients’ financial transactions.²⁸ The attorney’s most visible transactional role is likely to be providing a formal opinion regarding the legality of proposed transactions—such as mergers and acquisitions, joint ventures, and public offerings or private placements of securities. The attorney, however, will also often bear functional but not formal responsibility for the preparation or review of transactional and disclosure documents. For example, if the client is contemplating a public offering of securities that must be registered under state or federal securities laws, the attorney may be the principal drafter of the

²⁵ See *United States v. Arthur Young & Co.*, 465 U.S. 805, 815-18 (1984); 8 J. WIGMORE, *EVIDENCE IN TRIALS AT COMMON LAW* § 2286 (McNaughton rev. 1961 & Supp. 1991).

²⁶ MCCORMICK ON EVIDENCE § 76.2 (E. Cleary 3d ed. 1984). Accountants are also subject to an ethical obligation of nondisclosure. See AICPA CODE OF PROFESSIONAL CONDUCT Rule 301 (1988).

²⁷ B. LEFKOWITZ, *UNDERSTANDING FINANCIAL STATEMENTS* 39 (1979). An accountant can also issue three other types of audit reports. An adverse opinion is used in the rare cases when the auditor has affirmative knowledge that the overall financial statements are so materially misstated or misleading that they do not fairly present the company’s financial position. A disclaimer of opinion is issued when the accountant, because of a severe limitation on the permitted scope of her examination or the absence of a proper relationship of independence from the client, is unable to satisfy herself that the overall financial statements are fairly presented. A qualified report can issue when the accountant affirmatively believes that the overall financial statements are fairly presented but that there has been a limitation on the scope of the audit or a failure to follow GAAP. See A. ARENS & J. LOEBBECKE, *supra* note 21, at 43-44.

²⁸ See generally Block, *An Overview: Responsibilities of Attorneys Under the Federal Securities Laws*, 36 BUS. LAW. 1781, 1781 (1981); Frank, *A Higher Duty: A New Look at the Ethics of the Corporate Lawyer*, 26 CLEV. ST. L. REV. 337, 339-40 (1977); *Report by Special Committee on Lawyers’ Role in Securities Transactions*, 32 BUS. LAW. 1879, 1884-86 (1977).

registration statement and other relevant documents. The attorney may also be asked by the client—more precisely, by the client's officers or directors—to perform a due diligence investigation to ascertain the accuracy and completeness of the information contained in the registration statement.²⁹ Similar procedures might well be employed in unregistered transactions to satisfy the concerns or demands of interested parties.

Although an attorney's due diligence investigation³⁰ and an accountant's audit are superficially similar, they have notable differences. First, information acquired by attorneys from their clients in the course of their duties universally is subject to evidentiary privileges.³¹ Second, investigating attorneys are not subject to, and do not have the benefit of, a detailed set of authoritative operational guidelines equivalent to GAAS. Third, the scope and purposes of an audit and a due diligence investigation differ in a somewhat paradoxical way. An accountant must maintain a stance of independence from the client, but is not obliged, or always inclined, to structure the audit actively to search for errors or fraud.³² An attorney, in contrast, has an ethical obligation to

²⁹ Due diligence is a defense available to defendants other than the issuer of securities in suits under section 11 of the Securities Act of 1933. 15 U.S.C. § 77k(b)(3) (1988). Nonexperts who are subject to liability under the statute—such as officers who sign the registration statement, *id.* at § 77k(a)(1), and directors, *see id.* at § 77k(a)(2)—are shielded from liability for misstatements in the registration statement if they can demonstrate that “after reasonable investigation, [they had] reasonable ground to believe and did believe,” that the statements in question were not misleading at the time the registration statement became effective. *Id.* at § 77k(b)(3)(A). The statute sets forth somewhat less onerous requirements for establishing the due diligence defense with respect to statements made on the authority of experts or official documents. *Id.* at §§ 77k(b)(3)(C), (D). In point of fact, officers and directors subject to section 11 cannot escape personal liability by having their attorneys conduct a due diligence inquiry on their behalf. *See Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 685–86, 697 (S.D.N.Y. 1968). However, if they are unable or unwilling to conduct the inquiry themselves, they are likely to have attorneys examine the registration statement to identify potential problems.

³⁰ We henceforth use this term to refer generically to the attorney's role in assuring the accuracy of disclosure documents, without regard to the applicability of section 11 of the 1933 Act. Such investigations might involve a review of items like the company's basic chartering documents, the minutes of its board of directors' meetings, and its major contracts and agreements such as pension plans, profit sharing agreements, executive compensation agreements, supplier contracts, and credit arrangements; a check of the company's standing with regulatory officials; and, when necessary, meetings with the client's bankers and accountants.

³¹ MCCORMICK, *supra* note 26, at § 72. Attorneys are also subject to an ethical duty of nondisclosure. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 4 (1986).

³² *See* text accompanying notes 23–24. Among other reasons, audits necessarily rely on sampling, and by its nature a sampling process will systematically reveal only relatively pervasive errors or fraud. Nonetheless, it may be possible and desirable in limited circumstances to design an audit to ferret out specific errors.

pursue zealously the interests of the client,³³ but in practice might well be more “adversarial” towards the client than is the accountant. For example, in federally regulated public offerings in which the officers and directors of the filing company have effectively entrusted their due diligence responsibilities to attorneys, the corporate principals stand essentially as statutory guarantors against undetected misrepresentations in the filed documents.³⁴ Prudence may thus require a careful attorney actively to seek out errors or fraud in areas where accountants ordinarily may not.

In the end, however, these differences probably will not impress third-party users of documents prepared or examined by attorneys.³⁵ Users of these documents may rely on the attorney’s investigation—or the attorney’s care in preparing the documents—to the same extent that they rely on the accountant’s certification of financial statements. When the documents or reports contain inaccuracies that are plausibly the result of an attorney’s negligence, parties who suffer losses are likely to view the responsible attorney as an attractive defendant—especially when the more obvious defendants are judgment proof.³⁶

II. RECENT DEVELOPMENTS IN PROFESSIONAL THIRD-PARTY LIABILITY

As Part I illustrates, many of the common tasks performed by accountants and attorneys in financial transactions can expose practitioners to third-party allegations of negligent misrepresentation. Moreover, the transactional roles of accountants and attorneys are in many ways very similar, especially when viewed from the perspective of third parties. Nonetheless, the courts that have addressed third-party claims of negligent misrepresentation have not always treated the two professions similarly. A review of the relevant case law demonstrates that courts have generally been quite reluctant to apply to attorneys the expansive theories of liability that are increasingly being applied

³³ MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 7 (1986).

³⁴ See *supra* note 29.

³⁵ See Note, *Attorneys’ Negligence and Third Parties*, 57 N.Y.U. L. REV. 126, 137 (1982).

³⁶

Most often an accounting [or law] firm is sued when one of its clients goes broke. By that point the lined-up creditors at the bankruptcy court are like the customers at a [communist] meat store; even for those at the front of the line, the pickings are slim. Any individual officers who mismanaged or looted the company are likely to be off the scene or assetless.

Lawson & Olsen, *supra* note 13, at 34.

to accountants.³⁷ The remainder of Part II describes this phenomenon; Part III examines the reasons behind it and speculates on its likely durability.

Several notes on methodology are appropriate here. First, in order to assure a comparison of apples to apples, this study is formally limited to published opinions in which courts dealing with third-party claims against accountants or attorneys directly address the tort of negligent misrepresentation. Decisions involving other claims are noted, if at all, only in passing, even if they purport to announce general liability standards. Accordingly, this study is not intended to be an authoritative account of the law of professional third-party liability, or even an authoritative account of the law of professional third-party liability for negligent misrepresentation.³⁸ Its purposes, rather, are to illustrate as starkly as possible the different treatment sometimes given to attorneys and accountants in seemingly identical cases and to isolate a context in which the reasons for this different treatment can be examined.³⁹ Second, we only analyze cases decided during or after 1968, which seems to mark the beginning of the modern era of expanded professional liability. This restriction no doubt causes a significant understatement of the vitality of traditional privity rules, as jurisdictions still governed by pre-1968 cases adopting a privity standard are not encompassed. Finally, while we write as though our post-1968 sample of cases involving third-party claims of negligent misrepresentation is all-inclusive, we are humble enough to acknowledge that this is a hopeless pretension.

A. *Trends in Accountants' Liability*

Courts currently choose from four different theories when determining the scope of an accountant's liability for negligent misrepresentation: a theory requiring the plaintiff to prove privity of contract or an equivalent relationship

³⁷ See *infra* note 76 and accompanying text.

³⁸ Courts do not appear to distinguish between claims of negligent misrepresentation and other potential third-party claims, nor is there any obvious reason why they should do so.

³⁹ Our informal examination of a broader sample of cases suggests that the third-party negligent misrepresentation cases are in fact reasonably representative of third-party cases generally. Our failure to consider jurisdictions that depart from the privity rule in cases involving torts other than negligent misrepresentation, see, e.g., *Collins v. Binkley*, 750 S.W.2d 737, 738–39 (Tenn. 1988) (suggesting a general departure from the privity rule in cases involving attorneys), is largely offset by our failure to consider jurisdictions that have endorsed the privity rule in similar contexts. See, e.g., *Copenhaver v. Rogers*, 238 Va. 361, 366–71, 384 S.E.2d 593, 595–98 (1989) (refusing to recognize attorney liability even to beneficiaries of wills for negligent drafting). Any remaining bias in favor of privity rules appears to be offset by the temporal distortions discussed below. More significantly, use of a broader sample of cases would not alter our account of the reasons given by courts for departing from or retaining traditional privity rules.

between himself and the accountant; an approach based on section 552 of the *Restatement (Second) of Torts*,⁴⁰ which permits suit by members of a specific class of persons who the accountant knows will rely on the audit opinion or other document; a less focused approach that balances a variety of factors representing both contract and tort principles; and a theory imposing liability on the accountant to any foreseeable parties who rely on the accountant's work product. The law presently exhibits a noticeable, though nonuniform, trend away from the privity rule and towards more expansive theories of liability.

The 1931 opinion by Chief Judge Benjamin Cardozo of the New York Court of Appeals in *Ultramares Corp. v. Touche, Niven & Co.*⁴¹ is the leading decision setting forth the rule that accountants are liable for negligence only to those persons with whom they are in privity.⁴² Specifically, the opinion required the plaintiff to establish either privity of contract or "[a] bond . . . so close as to approach that of privity."⁴³ For the purposes of this Article's analysis, privity includes third-party beneficiary relationships.⁴⁴ The theory sounds in contract rather than tort: the accountant's duty results from the contractual relationship between the parties, and the potential scope of liability is thus entirely within the accountant's control. This approach dominated the law for many years, and eight or nine jurisdictions⁴⁵ have affirmed or reaffirmed their adherence to it in the past two decades.⁴⁶

⁴⁰ See *infra* note 48.

⁴¹ 255 N.Y. 170, 174 N.E. 441 (1931).

⁴² The rule was applied as early as 1919. See *Landell v. Lybrand*, 264 Pa. 406, 107 A. 783 (1919).

⁴³ *Ultramares*, 255 N.Y. at 182-83, 174 N.E. at 446.

⁴⁴ Some commentators treat cases involving third-party beneficiaries as exceptions to a privity rule. See Hilliker, *supra* note 11, at 61 n.145; Note, *supra* note 13, at 11-14; Note, *supra* note 2, at 328-29; Note, *supra* note 35, at 138-40. Because privity doctrines evolved before third-party beneficiary theory became a settled feature of contract law, this approach has historical justification. Functionally, however, once the idea of contract enforcement by third-party beneficiaries is accepted, there is little reason not to incorporate such third parties into the chain of privity.

⁴⁵ With some hesitation, we treat federal courts applying state law as authoritative sources of that state's law.

⁴⁶ See *Stephens Industries, Inc. v. Haskins & Sells*, 438 F.2d 357, 359-60 (10th Cir. 1971) (applying Colorado law); *Toro Co. v. Krouse, Kern & Co.*, 644 F. Supp. 986, 994 (N.D. Ind. 1986), *aff'd*, 827 F.2d 155, 159-62 (7th Cir. 1987) (applying Indiana law); *Robertson v. White*, 633 F. Supp. 954, 970-71 (W.D. Ark. 1986) (applying Arkansas law); *Colonial Bank v. Ridley & Schweigert*, 551 So. 2d 390, 395 (Ala. 1989); *Idaho Bank Co. & Trust v. First BanCorp.*, 115 Idaho 1082, 1084, 772 P.2d 720, 722-23 (1989); *Thayer v. Hicks*, 243 Mont. 138, 148, 793 P.2d 784, 791 (1990) (adopting what might be called a modified privity rule, which imposes liability "if the accountant actually knows that a specific third party intends to rely upon his work product and only if the reliance is in connection with a particular transaction or transactions of which the accountant is aware

The *Restatement* approach, first set forth in 1968 by a federal district court in *Rusch Factors, Inc. v. Levin*,⁴⁷ broadens the privity rule in a subtle but important respect. Section 552 of the *Restatement (Second) of Torts* states that accountants who provide audit reports or other financial information to a client owe a duty of care not only to the client, but also to "the person or one of a limited group of persons for whose benefit and guidance [the accountant] intends to supply the information or knows that the recipient intends to supply it."⁴⁸ Under this approach, the accountant can be liable for negligence to any member of a particular class of individuals who the accountant knows will be using her work product, while under the privity rule, the accountant can be liable only to specifically identified individuals who both the accountant and the client intend to be beneficiaries of the principal contract.⁴⁹ Although one commentator has persuasively argued that the *Restatement* approach can be characterized as merely an application of the modern law of third-party beneficiary contracts,⁵⁰ the approach interjects a modest tort element into the analysis by permitting liability to run to persons the accountant knows will be given the work product but who the accountant does not, in fact, intend to benefit. In the more than two decades since *Rusch Factors* was decided, at least sixteen jurisdictions have adopted some version of the *Restatement* approach.⁵¹

when he prepares the work product"); *Citizens Nat'l Bank v. Kennedy & Coe*, 232 Neb. 477, 479-80, 441 N.W.2d 180, 182 (1989); *Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536, 553, 483 N.E.2d 110, 118, 493 N.Y.S.2d 435, 443 (1985); *cf. Brumley v. Touche, Ross & Co.*, 123 Ill. App. 3d 636, 638-43, 463 N.E.2d 195, 198-200 (1984) (seeming to endorse both the *Restatement* test and a third-party beneficiary theory).

⁴⁷ 284 F. Supp. 85 (D.R.I. 1968).

⁴⁸ *RESTATEMENT (SECOND) OF TORTS* § 552(2)(a) (1977). Section 552 reads in relevant part:

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in Subsection (3) the liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

⁴⁹ See Gossman, *supra* note 13, at 218; Hagen, *Accountants' Common Law Negligence Liability to Third Parties*, 1988 COLUM. BUS. L. REV. 181, 199.

⁵⁰ See Gossman, *supra* note 13, at 220-21.

⁵¹ See *First Nat'l Bank of Commerce v. Monco Agency*, 911 F.2d 1053, 1060-61 (5th Cir. 1990) (applying Louisiana law); *Ingram Industries v. Nowicki*, 527 F. Supp. 683, 684

In *Aluma Kraft Manufacturing Co. v. Elmer Fox & Co.*,⁵² the Missouri Court of Appeals employed a "balancing of factors" test⁵³ to hold an accountant liable to known third parties for whose benefit and guidance the accountant supplied the information.⁵⁴ While liability could have been imposed in *Aluma Kraft* under the *Restatement* approach, and conceivably even under a privity standard,⁵⁵ the court instead spelled out a number of factors to be considered in determining liability: "(1) the extent to which the transaction was intended to affect the plaintiff; (2) the foreseeability of harm to him; (3) the degree of certainty that the plaintiff suffered injury; and (4) the closeness of the connection between the defendant's conduct and the injury suffered."⁵⁶ The last three factors are traditional elements of a tort analysis. The first, focusing on the intentions of the accountant and client, draws on contract principles. A

(E.D. Ky. 1981) (applying Kentucky law); *Rusch Factors*, 284 F. Supp. at 90-93 (applying Rhode Island law); *First Fla. Bank v. Max Mitchell & Co.*, 558 So. 2d 9, 12-16 (Fla. 1990); *Badische Corp. v. Caylor*, 257 Ga. 131, 132-33, 356 S.E.2d 198, 199-200 (1987); *Pahre v. Auditor of the State*, 422 N.W.2d 178, 179-82 (Iowa 1988); *Law Offices of Lawrence J. Stockler v. Rose*, 436 N.W.2d 70, 81-82, 174 Mich. App. 14, 34-37 (1989) (adopting the *Restatement* test as the minimum standard of liability and specifically reserving judgment on adoption of a broader standard), *appeal denied*, 434 Mich. 862 (1990); *Bonhiver v. Graff*, 311 Minn. 111, 121, 248 N.W.2d 291, 298-303 (1976); *Spherex, Inc. v. Alexander Grant & Co.*, 122 N.H. 898, 902-06, 451 A.2d 1308, 1310-13 (1982); *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 322 N.C. 200, 211-15, 367 S.E.2d 609, 615-18 (1988); *Haddon View Inv. Co. v. Coopers & Lybrand*, 70 Ohio St. 2d 154, 155-57, 436 N.E.2d 212, 214-15 (1982); *Bethlehem Steel Corp. v. Ernst & Whinney*, No. 861 (Tenn. App. Nov. 21, 1989) (LEXIS, States library, Tenn. file), *appeal granted*, (Tenn. May 14, 1990) (LEXIS, States library, Tenn. file); *Shatterproof Glass Corp. v. James*, 466 S.W.2d 873, 876-80 (Tex. Ct. App. 1971); *Milliner v. Elmer Fox & Co.*, 529 P.2d 806, 808 (Utah 1974); *First Nat'l Bank v. Crawford*, 386 S.E.2d 310, 313 (W. Va. 1989); *cf. Brumley v. Touche, Ross & Co.*, 123 Ill. App. 3d 636, 638-43, 463 N.E.2d 195, 198-201 (1984) (seeming to endorse both the *Restatement* test and a third-party beneficiary theory). Kansas has adopted what amounts to the *Restatement* rule by statute. *See* KAN. STAT. ANN. § 1-402 (Supp. 1990).

⁵² 493 S.W.2d 378 (Mo. App. 1973).

⁵³ The test was first described in a California case holding a notary public liable to an intended beneficiary of a will for failing to obtain the proper attestation. *Biakanja v. Irving*, 49 Cal. 2d 647, 650, 320 P.2d 16, 19 (1958). The California courts later applied the same test to an attorney under similar circumstances. *Lucas v. Hamm*, 56 Cal. 2d 583, 588-91, 364 P.2d 685, 687-89, 15 Cal. Rptr. 821, 823-25 (1961) (holding an attorney liable to an intended beneficiary of a negligently prepared will), *cert. denied*, 368 U.S. 987 (1962). Although *Lucas* did not directly invoke a third-party beneficiary analysis, its conclusion is not necessarily inconsistent with our understanding of a privity approach.

⁵⁴ 493 S.W.2d at 381-83; *see also* *Lindner Fund v. Abney*, 770 S.W.2d 437, 438 (Mo. Ct. App. 1989) (reaffirming *Aluma Kraft*).

⁵⁵ Gossman, *supra* note 13, at 221.

⁵⁶ 493 S.W.2d at 383.

"balancing" analysis in which the first factor predominates will not differ significantly from a privity approach; if the accountant, in fact, intended to benefit the plaintiff, then the latter might well qualify as a third-party beneficiary under applicable contract law.

In recent years, four states have dramatically extended the accountant's liability to all persons the accountant reasonably should have foreseen might obtain and rely on her reports.⁵⁷ This theory represents an almost complete movement from contract to tort principles.⁵⁸ The class of potential plaintiffs could conceivably extend as far as the general investing public; it is not limited by either the accountant's knowledge of the use of the product by third parties or the absence of an intention to benefit them.⁵⁹

In all, thirty jurisdictions have directly addressed the issue of an accountant's liability to third parties for negligent misrepresentation since 1968. Of those, at least twenty-one, and possibly twenty-two,⁶⁰ have to some degree extended liability beyond even a loosely defined chain of privity that includes third-party beneficiaries, and at least four have clearly done so in substantial measure.

B. Trends in Attorneys' Liability

Modern courts have analyzed claims of negligent misrepresentation against attorneys in terms of the same four tests applied to similar claims against accountants. They have, however, adopted the various tests in very different proportions in cases involving the two professions.

The privity rule for attorneys' liability is followed in at least nine states—a clear majority of the jurisdictions that have directly spoken to the question in recent years.⁶¹ Significantly, the privity standard for attorneys is applied even

⁵⁷ See *International Mortgage Co. v. John P. Butler Accountancy Corp.*, 177 Cal. App. 3d 806, 810–20, 223 Cal. Rptr. 218, 220–27 (1986); *Touche Ross Co. v. Commercial Union Ins.*, 514 So. 2d 315, 318–23 (Miss. 1987) (relying heavily on a state statute); *H. Rosenblum, Inc. v. Adler*, 93 N.J. 324, 334–53, 461 A.2d 138, 142–53 (1983); *Citizens State Bank v. Timm, Schmidt & Co.*, 113 Wis. 2d 376, 382–87, 335 N.W.2d 361, 364–66 (1983).

⁵⁸ The movement is less than complete in New Jersey, which permits accountants to avoid liability by limiting distribution of their documents. See *Adler*, 93 N.J. at 352–53, 461 A.2d at 153 (dictum); *Cammer v. Bloom*, 711 F. Supp. 1264, 1298–99 (D.N.J. 1989) (so construing *Adler*).

⁵⁹ This is evidently not true in New Jersey. See *Cammer*, 711 F. Supp. at 1298.

⁶⁰ Illinois is difficult to categorize. See *supra* notes 46, 51.

⁶¹ See *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1131–33 (5th Cir. 1988) (applying Louisiana law), *cert. denied*, 492 U.S. 918 (1989); *Ackerman v. Schwartz*, 733 F. Supp. 1231, 1241–43 (N.D. Ind. 1989) (applying Indiana law), *appeal dismissed*, 922 F.2d 843 (7th Cir. 1991); *Moss v. Zafiris*, 524 So. 2d 1010, 1011 (Fla. 1988); *Flaherty v. Weinberg*, 303 Md. 116, 130–32, 492 A.2d 618, 625–26 (1985); *Robertson v. Gaston Snow & Ely*

in some jurisdictions that subject accountants to more expansive standards of liability.⁶² The most dramatic example is Wisconsin, which follows the privity rule for attorneys⁶³ and the broad foreseeability standard for accountants.⁶⁴

The *Restatement* test is by far the most popular standard among modern courts addressing the third-party liability of accountants for negligent misrepresentation. However, only one decision—rendered by the Third Circuit Court of Appeals applying Pennsylvania law⁶⁵—appears specifically and unambiguously to have adopted the *Restatement* test for similar claims against attorneys.⁶⁶ A second decision, *Garcia v. Rodey, Dickason, Sloan, Akin & Robb*,⁶⁷ might also fall into this category. In *Garcia*, the New Mexico Supreme

Bartlett, 404 Mass. 515, 522, 536 N.E.2d 344, 348 (1989), *cert. denied*, 493 U.S. 894 (1989); *Schuler v. Meschke*, 435 N.W.2d 156, 162–63 (Minn. Ct. App. 1989); *Council Commerce Corp. v. Schwartz, Sachs & Kamhi*, 144 A.D.2d 422, 424, 534 N.Y.S.2d 1, 2 (1988), *appeal denied*, 74 N.Y.2d 606, 543 N.E.2d 85, 544 N.Y.S.2d 820 (1989); *First Mun. Leasing v. Blankenship, Potts, Aikman, Hagin & Stewart*, 648 S.W.2d 410, 413 (Tex. Ct. App. 1983); *Green Spring Farms v. Kersten*, 136 Wis. 2d 304, 319–31, 401 N.W.2d 816, 822–27 (1987). Illinois' and Nebraska's endorsements of the privity rule, while not meeting the strict standards of our survey, are too forceful to escape notice. *See McLane v. Russell*, 131 Ill. 2d 509, 514–17, 546 N.E.2d 499, 501–02 (1989); *Citizens Nat'l Bank v. Kennedy & Coe*, 232 Neb. 477, 480, 441 N.W.2d 180, 182 (1989); *cf. Kirby v. Chester*, 174 Ga. App. 881, 884–86, 331 S.E.2d 915, 918–20 (1985) (finding an attorney liable under third-party beneficiary theory, but suggesting, perhaps unintentionally, that mere knowledge on the part of an attorney that a third party will rely on his opinion is sufficient to generate liability).

⁶² Compare *Abell*, 858 F.2d at 1131–33; *Moss*, 524 So. 2d at 1011; *Schuler*, 435 N.W.2d at 162–63; and *First Mun. Leasing*, 648 S.W.2d at 413 (applying a privity rule for attorney liability in, respectively, Louisiana, Florida, Minnesota, and Texas), with *First Nat'l Bank of Commerce v. Monco Agency*, 911 F.2d at 1060–61; *First Fla. Bank v. Max Mitchell & Co.*, 558 So. 2d at 12–16 (Fla. 1990); *Bonhiver v. Graff*, 311 Minn. 111, 119–31, 248 N.W.2d at 298–303; *Shatterproof Glass Corp. v. James*, 466 S.W.2d at 876–80 (Tex. Ct. App. 1971) (applying the *Restatement* test for accountant liability in the same four states).

⁶³ See *Kersten*, 136 Wis. 2d at 319–31, 401 N.W.2d at 822–27. The decision in *Kersten* was expressly limited to its facts, *id.* at 330–31, 401 N.W.2d at 826–27, but this was clearly done in order to distinguish it from decisions in which attorneys were held liable to nonclients who were in essence third-party beneficiaries. *Id.* at 321–30, 401 N.W.2d at 823–26; see also *Rendler v. Markos*, 154 Wis. 2d 420, 426–27, 453 N.W.2d 202, 204–05 (Ct. App. 1990) (reaffirming the privity rule for lawyers).

⁶⁴ See *Citizens State Bank v. Timm, Schmidt & Co.*, 113 Wis. 2d 376, 382–87, 335 N.W.2d 361, 364–66 (1983).

⁶⁵ See *Eisenberg v. Gagnon*, 766 F.2d 770, 779–80 (3d Cir.), *cert. denied sub nom. Waserstrom v. Eisenberg*, 474 U.S. 946 (1985).

⁶⁶ At least one decision outside the scope of our survey has suggested that the *Restatement* test is generally applicable to third-party claims against attorneys. *Collins v. Binkley*, 750 S.W.2d 737, 738–39 (Tenn. 1988).

⁶⁷ 106 N.M. 757, 750 P.2d 118 (1988).

Court invoked the *Restatement* while claiming to reject a privity standard. With no apparent sense of irony, however, the court found the *Restatement* test inapplicable because the attorney owed no duty of care to third-party plaintiffs.⁶⁸ Thus, the governing standard in New Mexico is perhaps best described as the *Restatement* in name but privity in fact.

California courts balance a number of factors when evaluating third-party claims of negligent misrepresentation against attorneys, which on occasion has led to holdings that a nonclient has a cause of action for negligent misrepresentation against an attorney.⁶⁹ As with the balancing test adopted for accountants by Missouri courts,⁷⁰ it is not clear how far this test departs in fact as well as theory from a privity standard.

Only one jurisdiction, Oklahoma, clearly appears to hold attorneys liable to all reasonably foreseeable persons who rely on the attorneys' negligent misrepresentations.⁷¹ Even though the case that established such liability involved a known, limited class of plaintiffs, and liability was thus consistent with the less dramatic *Restatement* test,⁷² the opinion treated the question as one of general tort law, to which it applied the jurisdiction's ordinary foreseeability standards of negligence liability.⁷³

All told, of the fourteen jurisdictions explicitly to consider third-party attorney liability for negligent misrepresentation since 1968, at least nine, and possibly eleven,⁷⁴ or approximately seventy percent, have retained the privity

⁶⁸ *Id.* at 760-62, 750 P.2d at 121-23; *cf.* *Holland v. Lawless*, 95 N.M. 490, 496-97, 623 P.2d 1004, 1011 (Ct. App. 1981) (seemingly adopting the *Restatement* test).

⁶⁹ *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*, 57 Cal. App. 3d 104, 110-11, 128 Cal. Rptr. 901, 905-06 (1976); *see also* *Cicone v. URS Corp.*, 183 Cal. App. 3d 194, 207-11, 227 Cal. Rptr. 887, 895-97 (1986) (following *Roberts*). At least three jurisdictions have indicated in other contexts that this approach is generally applicable to third-party claims against attorneys. *See* *Franko v. Mitchell*, 158 Ariz. 391, 397-402, 762 P.2d 1345, 1352-56 (Ct. App. 1988); *Pizel v. Zuspann*, 795 P.2d 42, 50-51 (1990); *Jenkins v. Wheeler*, 69 N.C. App. 140, 143, 316 S.E.2d 354, 356-57, *review denied*, 311 N.C. 758, 321 S.E.2d 136 (1984).

⁷⁰ *See* text accompanying notes 48-51.

⁷¹ *Bradford Sec. Processing Servs. v. Plaza Bank and Trust*, 653 P.2d 188, 190 (Okla. 1982). *Cf.* *City Nat'l Bank v. Rodgers & Morgenstein*, 155 Mich. App. 318, 323-25, 399 N.W.2d 505, 507-08 (1986) (suggesting in dicta that lawyers are liable to foreseeable third-party plaintiffs for negligent misstatements of fact but not for negligently offered opinions), *appeal denied*, 428 Mich. 885 (1987); *Zendell v. Newport Oil Corp.*, 226 N.J. Super. 431, 438-39, 544 A.2d 878, 881-82 (App. Div. 1988) (suggesting that the foreseeability rule of *Adler* applies generally to attorneys as well as accountants).

⁷² *See* *Bradford*, 653 P.2d at 189.

⁷³ *Id.* at 190-91; *see* *Vanguard Prod., Inc. v. Martin*, 894 F.2d 375, 377-79 (10th Cir. 1990) (applying a broad interpretation of *Bradford*).

⁷⁴ Georgia and New Mexico are difficult to describe. *See supra* note 61 & text accompanying notes 67-68.

standard. In contrast, only thirty percent of the jurisdictions that have considered the issue since 1968 have retained the privity rule in cases involving accountants.

III. DIFFERENT STANDARDS FOR ATTORNEYS AND ACCOUNTANTS: WHERE IT CAME FROM AND WHERE IT IS GOING

There is reason to believe that the pattern of liability sketched out in Part II will change in the near future—in a way that will please neither most accountants nor most attorneys. As the rest of this discussion will reveal, the evidence for this prediction is admittedly spotty; the reasoning of the opinions catalogued in Part II is frequently terse or unintelligible, and extrapolation from those opinions is thus a treacherous enterprise.⁷⁵ Nonetheless, a close look at the reasons typically given by courts for departing from the privity standard suggests that attorneys may soon have considerable cause for concern.

A. *Why Extend Liability?*

The courts that have extended professional liability beyond the chain of privity have offered—albeit usually without explanation or analysis—a welter of reasons for doing so.⁷⁶ Those reasons can usefully be grouped into three categories.

First, a substantial percentage of the cases rely heavily, if not exclusively, on what can broadly be called doctrinal considerations. These considerations take the form either of applications of precedents or of attempts to weave professional third-party liability into a wider legal fabric. The most straightforward application of precedent was *Milliner v. Elmer Fox & Co.*⁷⁷ In *Milliner*, the Utah Supreme Court justified adopting the *Restatement* test for accountants solely by referring to similar cases in other jurisdictions involving

⁷⁵ We are also assuming that the reasons given in court decisions are tolerably accurate reflections of the actual judicial process. We are sensitive to the problems with this assumption (especially given the role of law clerks in the production of modern judicial opinions), but we are unpersuaded that any alternative assumptions are likely to generate better descriptions or predictions.

⁷⁶ Several cases quite simply offer nothing recognizable as reasons for their decisions. See *Ingram Indus. v. Nowicki*, 527 F. Supp. 683, 684 (E.D. Ky. 1981) (adopting, without discussion, the *Restatement* test as Kentucky law for accountants' liability); *Bonhiver v. Graff*, 311 Minn. 111, 119–31, 248 N.W.2d 291, 298–303 (1976) (adopting, without explanation, the *Restatement* test as Minnesota law for accountants' liability).

⁷⁷ 529 P.2d 806 (Utah 1974).

precisely the issue of accountants' liability to third parties for negligent misrepresentation.⁷⁸

Five other decisions have relied on less direct precedents involving professionals other than accountants or attorneys. In *Badische Corp. v. Caylor*,⁷⁹ the Georgia Supreme Court ruled that the question of an accountant's third-party liability for negligent misrepresentation was "controlled"⁸⁰ by a prior holding adopting the *Restatement* test as the measure of third-party professional liability in the context of an "engineer who issues a report on the condition of a building."⁸¹ Similarly, in *First National Bank of Commerce v. Monco Agency, Inc.*,⁸² the Fifth Circuit Court of Appeals, applying Louisiana law, noted that Louisiana courts have generally "shaped the dimensions of this tort [of negligent misrepresentation] by consulting the definition adopted by the *Restatement*,"⁸³ and found "no reason to presume that Louisiana would treat the accounting profession differently."⁸⁴ The Oklahoma Supreme Court in *Bradford Securities Processing Services, Inc. v. Plaza Bank & Trust*,⁸⁵ applied a foreseeability test to a suit for negligent misrepresentation by a purchaser of bonds⁸⁶ against the issuer's attorney, on the ground that the case was controlled by a prior decision permitting a homeowner to bring suit for negligence against an architect who was employed by the homeowner's contractor.⁸⁷ In *Bethlehem*

⁷⁸ *Id.* at 808; see also *Badische Corp. v. Caylor*, 257 Ga. 131, 133 n.2, 356 S.E.2d 198, 200 n.2 (1987) (noting the widespread adoption of the *Restatement* test for accountants); *Shatterproof Glass Corp. v. James*, 466 S.W.2d 873, 877-78 (Tex. Ct. App. 1971) (adopting the *Restatement* test for accountants in part on the authority of *Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85 (D.R.I. 1968)).

⁷⁹ 257 Ga. 131, 356 S.E.2d 198 (1987).

⁸⁰ *Id.* at 132, 356 S.E.2d at 199.

⁸¹ *Robert & Co. v. Rhodes-Haverty Partnership*, 250 Ga. 680, 300 S.E.2d 503 (1983); cf. *Franko v. Mitchell*, 158 Ariz. 391, 398-402, 762 P.2d 1345, 1352-56 (Ct. App. 1988) (applying a balancing test to a third-party malpractice claim against an attorney, largely on the basis of a state supreme court decision applying a balancing test to a third-party claim against an architect).

⁸² 911 F.2d 1053 (5th Cir. 1990).

⁸³ *Id.* at 1060.

⁸⁴ *Id.* at 1061.

⁸⁵ 653 P.2d 188 (Okla. 1982).

⁸⁶ Actually, the plaintiff was a pledgee foreclosing on bonds purchased by the pledgor. The distinction between a real purchaser and a forced purchaser like a foreclosing pledgee would seem to be relevant only insofar as forced purchasers may have difficulty proving that they relied on whatever misrepresentations are alleged to have occurred. The certified question in *Bradford Securities*, 653 P.2d at 189, assumed away the reliance problem.

⁸⁷ *Id.* at 190-91 (relying on *Keel v. Titan Construction*, 639 P.2d 1228, 1231-32 (Okla. 1982)). In point of fact, the homeowner in *Keel* was held to be a third-party beneficiary of the contract between the contractor and architect, *id.* at 1231, but that

Steel Corp. v. Ernst & Whinney,⁸⁸ the Tennessee Court of Appeals adopted a different test but used the same doctrinal justification, applying the *Restatement* test for accountants largely on the strength of prior decisions applying the *Restatement* to other professionals.⁸⁹ Finally, in *First National Bank v. Crawford*,⁹⁰ the West Virginia Supreme Court explained that its *Restatement* test for accountants "is not a commercially unreasonable rule, nor is it any different from that applied to other professions who issue opinions or reports."⁹¹

Also using precedent, but in a slightly different way, the California Court of Appeal in *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*⁹² relied on cases involving the same profession but different torts. The court invoked a balancing test to permit a partnership's creditor to bring a third-party claim for negligent misrepresentation against the partnership's attorney.⁹³ Apart from a passing reference to an obviously inapplicable provision of the *Restatement (Second) of Torts*,⁹⁴ the court relied entirely on prior California decisions. Two cases permitted third-party suits against attorneys by intended beneficiaries of wills,⁹⁵ and another allowed a suit by the client of a collection agency whose attorney negligently failed to recover a collectible account.⁹⁶

holding did not appear to affect the court's discussion of the homeowner's tort action against the architect.

⁸⁸ No. 861 (Tenn. App. Nov. 21, 1989), *appeal granted*, (Tenn. May 14, 1990) (LEXIS, States library, Tenn. file).

⁸⁹ *Id.*

⁹⁰ 386 S.E.2d 310 (W. Va. 1989).

⁹¹ *Id.* at 313; *see also* First Fla. Bank v. Max Mitchell & Co., 558 So. 2d 9, 13-14 (Fla. 1990) (adopting the *Restatement* test for accountants) (citing A.R. Moyer, Inc. v. Graham, 285 So. 2d 397, 402 (Fla. 1973), *rev'd on other grounds*, 458 So. 2d 766 (Fla. 1984) (modifying the privity rule for architects); First Am. Title Ins. v. First Title Serv., 457 So. 2d 467, 472-73 (Fla. 1984) (modifying the privity rule for title abstractors)).

⁹² 57 Cal. App. 3d 104, 128 Cal. Rptr. 901 (1976).

⁹³ *Id.* at 110-11, 128 Cal. Rptr. at 905-06.

⁹⁴ The court cited section 324A of the *Restatement (Second) of Torts*, which suggests that a person

who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person [under certain circumstances] for *physical harm* resulting from his failure to exercise reasonable care to protect his undertaking . . .

RESTATEMENT (SECOND) OF TORTS § 324A (1965) (emphasis added); *see* 57 Cal. App. 3d at 110-11, 128 Cal. Rptr. at 906. Of course, the typical action for negligent misrepresentation involves only financial harm.

⁹⁵ *See* Heyer v. Flaig, 70 Cal. 2d 223, 449 P.2d 161, 74 Cal. Rptr. 225 (1969); Lucas v. Hamm, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961).

⁹⁶ *See* Donald v. Garry, 19 Cal. App. 3d 769, 97 Cal. Rptr. 191 (1971).

In perhaps the strangest use of precedent to date, the Third Circuit Court of Appeals, in *Eisenberg v. Gagnon*,⁹⁷ held that Pennsylvania law required application of the *Restatement* test to attorneys⁹⁸ solely on the basis of prior Pennsylvania decisions applying section 552 of the *Restatement* to nonprofessionals.⁹⁹ Significantly, all three of the cases that unambiguously reject the privity standard for attorney-defendants in negligent misrepresentation suits relied entirely on one of these arguments from precedent.¹⁰⁰

In a different doctrinal vein, a comparable number of courts addressing accountants' liability have viewed rejection of the privity rule as a logical consequence of a wider movement away from privity.¹⁰¹ Several courts have expressed this idea by stating that there is no apparent reason not to impose third-party liability on accountants. The clear implication of that reasoning is that privity is a legal aberration that must be affirmatively justified.¹⁰²

A second group of cases—overlapping to some extent with the “doctrinal” cases, but dealing exclusively with accountant’s liability—invoke what might be called enterprise liability arguments: a series of policy concerns that have become something of a litany in modern decisions expanding the liability of manufacturers for defective products.¹⁰³ These cases maintain that abandonment of privity is necessary as a deterrent to encourage accountants to

⁹⁷ 766 F.2d 770 (3d Cir. 1985), *cert. denied*, 474 U.S. 946 (1985).

⁹⁸ *Id.* at 778.

⁹⁹ See *Rempel v. Nationwide Life Ins.*, 471 Pa. 404, 408, 370 A.2d 366, 367–68 (1977) (applying the *Restatement* to a first-party suit); *Mill-Mar, Inc. v. Statham*, 278 Pa. Super. 296, 299–300, 420 A.2d 548, 550–51 (1980) (applying the *Restatement* to a third-party suit against a nonprofessional land developer) (dictum), *appeal dismissed*, 499 Pa. 219, 452 A.2d 1017 (1982); *Muntan v. City of Monongahela*, 45 Pa. Commw. 23, 27 n.3, 406 A.2d 811, 813 n.3 (1979) (endorsing use of the *Restatement* to impose liability on a city for negligent misrepresentations by its employees).

¹⁰⁰ See *Eisenberg*, 766 F.2d at 778; *Roberts*, 57 Cal. App. 3d at 110–11, 128 Cal. Rptr. at 905–06; *Bradford Sec.*, 653 P.2d at 189–91.

¹⁰¹ See *International Mortgage Co. v. John P. Butler Accountancy Corp.*, 177 Cal. App. 3d 806, 812–16, 223 Cal. Rptr. 218, 221–22 (1986); *First Fla. Bank v. Max Mitchell & Co.*, 558 So. 2d 9, 13–14 (Fla. 1990); *Ryan v. Kanne*, 170 N.W.2d 395, 402 (Iowa 1969); *Aluma Kraft Mfg. Co. v. Elmer Fox & Co.*, 493 S.W.2d 378, 381–83 (Mo. App. 1973); *Spherex, Inc. v. Alexander Grant & Co.*, 122 N.H. 898, 903, 451 A.2d 1308, 1312 (1982); *H. Rosenblum, Inc. v. Adler*, 93 N.J. 324, 335–40, 461 A.2d 138, 145–47 (1983); *Shatterproof Glass Corp. v. James*, 466 S.W.2d 873, 877, 879 (Tex. Ct. App. 1971).

¹⁰² See *International Mortgage*, 177 Cal. App. 3d at 820, 223 Cal. Rptr. at 227; *Citizens State Bank v. Timm, Schmidt & Co.*, 113 Wis. 2d 376, 386–87, 335 N.W.2d 361, 366 (1983).

¹⁰³ See generally Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 14 J. LEGAL STUD. 461, 520–21 (1985).

take an appropriate level of precautions,¹⁰⁴ as a cost-spreading measure to distribute losses among the accountant's entire client base rather than among a small number of injured plaintiffs,¹⁰⁵ or as a fairness measure to shift losses from innocent investors to guilty accountants.¹⁰⁶ Perhaps because of their familiarity from other contexts, these concerns tend to be set forth baldly without discussion.

Finally, many courts have justified expanded liability for accountants by referring to the allegedly public role of the modern auditor.¹⁰⁷ *Ultramares* may have been correctly decided in 1931, they reason, but today the auditor realistically must be seen as serving more than just the client; the accountant also serves the third parties who typically rely on her work product. The vision of the public accountant held by these courts was well expressed by the United States Supreme Court in *United States v. Arthur Young & Co.*,¹⁰⁸ when it declined to recognize a work-product privilege for accountants' papers. The Court wrote:

By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust. To insulate from disclosure a certified public accountant's

¹⁰⁴ See *Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85 (D.R.I. 1968); *International Mortgage*, 177 Cal. App. 3d at 820, 223 Cal. Rptr. at 227; *Adler*, 93 N.J. at 351, 461 A.2d at 152-53; *Citizens State Bank*, 113 Wis. 2d at 384, 335 N.W.2d at 365; see also *Koehler v. Pulvers*, 614 F. Supp. 829, 849 (S.D. Cal. 1985) (invoking "the policy of preventing future harm" as a reason for holding an attorney liable to a third-party plaintiff under California law).

¹⁰⁵ See *Rusch Factors*, 284 F. Supp. at 91; *International Mortgage*, 177 Cal. App. 3d at 820, 223 Cal. Rptr. at 227; *Touche Ross v. Commercial Union Ins.*, 514 So. 2d 315, 322 (Miss. 1987); *Spherex*, 122 N.H. at 904, 451 A.2d at 1312; *Citizens State Bank*, 113 Wis. 2d at 384, 335 N.W.2d at 365.

¹⁰⁶ See *Rusch Factors*, 284 F. Supp. at 91; *International Mortgage*, 177 Cal. App. 3d at 820, 223 Cal. Rptr. at 227; *Commercial Union Ins.*, 514 So. 2d at 322; *Spherex*, 122 N.H. at 904, 451 A.2d at 1312; *Adler*, 93 N.J. at 351, 461 A.2d at 152.

¹⁰⁷ See *International Mortgage*, 177 Cal. App. 3d at 819-20, 223 Cal. Rptr. at 224-27; *First Fla. Bank*, 558 So. 2d at 15; *Law Offices of Lawrence J. Stockler v. Rose*, 174 Mich. App. 14, 36, 436 N.W.2d 71, 82 (1989); *Spherex*, 122 N.H. at 903-04, 451 A.2d at 1311-12; *Adler*, 93 N.J. at 346-47, 461 A.2d at 149-50; *Raritan River Steel Co. v. Cherry*, Bekaert & Holland, 322 N.C. 200, 211, 367 S.E.2d 609, 615 (1988); *Haddon View Inv. Co. v. Coopers & Lybrand*, 70 Ohio St. 2d 154, 157, 436 N.E.2d 212, 214-15 (1982); see *supra* notes 57-59 and accompanying text.

¹⁰⁸ 465 U.S. 805 (1984).

interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations.¹⁰⁹

Interestingly, strikingly similar sentiments can be found in the ethical code of the AICPA, which "emphasizes the [accounting] profession's responsibility to the public, a responsibility that has grown as the number of investors has grown, as the relationship between corporate managers and stockholders has become more impersonal, and as government increasingly relies on accounting information."¹¹⁰ The AICPA's view of its members' professional roles and responsibilities has not gone unnoticed by courts.¹¹¹

B. *Why Stop There?*

While the courts that have chosen to expand professional liability have been terse in offering explanations for their decisions,¹¹² courts that have declined to expand liability beyond the chain of privity have been positively laconic. In the case of jurisdictions that simply affirm or reaffirm the privity rule for both accountants and attorneys, this lack of explanation is not surprising; one would hardly expect courts to spend a great deal of time justifying their adherence to long settled doctrine. The silence is at least mildly puzzling, however, in jurisdictions where courts have extended liability for accountants beyond the chain of privity, but maintain the privity rule in suits brought against attorneys.¹¹³ Among those jurisdictions,¹¹⁴ the Texas courts have openly noted the divergence in liability standards and have suggested that it may not last much longer.¹¹⁵ Other courts, however, are wholly mute on the point.¹¹⁶ It is as though the "accountants' cases" and the "attorneys' cases" inhabit separate legal worlds.

¹⁰⁹ *Id.* at 817-18.

¹¹⁰ PROFESSIONAL STANDARDS, *supra* note 17, at ET § 53.04.

¹¹¹ See *International Mortgage*, 177 Cal. App. 3d at 817, 223 Cal. Rptr. at 224-25; *Raritan River Steel*, 322 N.C. at 211, 367 S.E.2d at 615.

¹¹² Our procedure of merely listing, without elaboration, the reasons that appear in court decisions omits nothing of interest.

¹¹³ We have found no jurisdiction in which attorneys are clearly held to a broader standard of liability than accountants.

¹¹⁴ See *supra* text accompanying notes 51-64.

¹¹⁵ See *Blue Bell, Inc. v. Peat, Marwick, Mitchell & Co.*, 715 S.W.2d 408, 413 (Tex. Ct. App. 1986).

¹¹⁶ See *First Nat'l Bank of Commerce v. Monco Agency*, 911 F.2d 1053, 1060-61 (5th Cir. 1990) (federal court applying Louisiana law) (applying the *Restatement* test to accountants without mention of prior cases in the jurisdiction applying a privity rule to attorneys); *First Fla. Bank v. Max Mitchell & Co.*, 558 So. 2d 9, 12-16 (Fla. 1990) (same); *Schuler v. Meschke*, 435 N.W.2d 156, 162-63 (Minn. Ct. App. 1989) (applying the privity

This kind of compartmentalization is familiar in other areas of the law,¹¹⁷ but the more similar the subject matter and extreme the difference in legal standards, the more one expects the rules to converge. It is therefore worth exploring whether the reasons that courts have given—and are likely to give in the future—for expanding the third-party liability of accountants can logically be confined to that profession.

1. *The Broad-Brush Sweep of Precedent and Enterprise Liability*

Courts that justify expanded third-party liability for accountants by referring to doctrinal considerations will have a difficult time keeping that expansion from engulfing the legal profession as well. This is particularly true with respect to jurisdictions that rely on a widespread abandonment of privity rules or on previous extensions of third-party liability to professionals like engineers or architects.¹¹⁸ By their nature, these considerations are general and on their face apply to attorneys as well as accountants. One could, of course, justify differential treatment of accountants and attorneys on doctrinal grounds simply by maintaining that the absence of third-party liability for attorneys is doctrinally more basic than principles such as erosion of privity or expanded liability for professionals. That is, one could treat the compartmentalization of attorneys' cases, and other professionals' cases as a primary element of doctrine that requires no external justification. Courts may already be categorizing the cases in this manner,¹¹⁹ and perhaps a tacit doctrinal classification of this sort will endure. However, given that all three of the jurisdictions that have unambiguously expanded attorney liability to third parties have done so on grounds of precedent¹²⁰ and that other jurisdictions

rule to attorneys without mention of the jurisdiction's prior adoption of the *Restatement* test for accountants); *Green Spring Farms v. Kersten*, 136 Wis. 2d 304, 319–31, 401 N.W.2d 816, 822–27 (1987) (applying a privity rule to attorneys without mention of the jurisdiction's prior adoption of the foreseeability test for accountants).

¹¹⁷ For example, everyone (we trust) recognizes that "race cases," "abortion cases," and "military cases" in constitutional law are worlds unto themselves. For a somewhat more mundane illustration of compartmentalization, see Scalia, *Sovereign Immunity and Nonstatutory Review of Federal Administrative Action: Some Conclusions from the Public-Lands Cases*, 68 MICH. L. REV. 867 (1970) (comparing the development of sovereign immunity doctrine in cases involving public land patents and in other contexts).

¹¹⁸ See *supra* notes 79–91 and accompanying text.

¹¹⁹ This might explain their failure to address the evident inconsistency in their treatment of attorneys and accountants.

¹²⁰ See *supra* text accompanying note 100. The decisions in Oklahoma and Pennsylvania illustrate this point more powerfully than do the decisions in California. The California court in *Roberts* relied on prior cases involving attorneys, while the Oklahoma court in *Bradford Securities* relied on a prior case involving an architect and the Third Circuit in *Eisenberg* relied on cases that did not involve professionals.

appear ready, and even eager, to expand attorney liability for similar reasons,¹²¹ there is good reason to assume that the broader doctrinal formulations still have force. Thus, it is important to ask whether there are any affirmative reasons likely to be accepted by courts for exempting attorneys from the expanded liability rules that have increasingly been applied to accountants in recent years.

No such reasons appear from an examination of the respective transactional roles of accountants and attorneys.¹²² Perhaps it is ordinarily more reasonable for third parties to rely on an accountant's formal certification of financial statements than on an attorney's informal due diligence investigation, but that affects only the likelihood that the plaintiff will be able to prove his case,¹²³ not the appropriateness of a separate legal standard for accountants and attorneys. Similarly, the fact that disclosures to attorneys, but not to accountants, are invariably subject to evidentiary privileges may well affect the mechanics of negligent misrepresentation suits in which confidential client information is part of the attorney's defense,¹²⁴ but it is not clear that an attorney-client relationship necessitates a different standard of liability. While there does not appear to be any direct authority concerning disclosure of confidential information by attorneys in third-party negligent misrepresentation suits,¹²⁵ there is analogous authority suggesting that such disclosure would—or at least could—be permissible.¹²⁶ If the prospect of disclosure poses a serious danger

¹²¹ See *supra* text accompanying notes 6–8.

¹²² See *supra* text accompanying notes 15–36.

¹²³ Reliance is generally an essential element of that case. See *supra* note 15.

¹²⁴ The privilege poses no problem when the client (or a client-designated beneficiary) is the plaintiff because the client can plausibly be said to have waived his privilege by bringing (or tacitly authorizing) suit. See E. EPSTEIN & M. MARTIN, *THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE* 96 (2d ed. 1989); McMonigle, *The Self Defense Exception to the Attorney-Client Privilege: Disclosure of the Client's Confidences or Personal Liability*, in *THE ATTORNEY-CLIENT PRIVILEGE UNDER SIEGE: PRESERVING AND PROTECTING IT IN CIVIL CASES* 278, 279–80 (1989). The waiver principle obviously does not apply when suit is brought by third parties.

¹²⁵ See McMonigle, *supra* note 124, at 288.

¹²⁶ See *First Fed. Sav. & Loan Ass'n v. Oppenheim, Appel, Dixon & Co.*, 110 F.R.D. 557, 566 (S.D.N.Y. 1986); E. EPSTEIN & M. MARTIN, *supra* note 130, at 96–97; McMonigle, *supra* note 130, at 282–90. Ethical rules also recognize the permissibility of disclosure. The *Model Code of Professional Responsibility* permits disclosure of client confidences when it is necessary for the attorney “to defend himself . . . against an accusation of wrongful conduct.” MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(C)(4) (1986). While it is true that this provision was clearly drawn in contemplation of “the situation where the client has sued the attorney for negligence or malpractice,” Note, *supra* note 2, at 22, its wording is general enough to cover defense of third-party suits. See also *First Fed. Sav. & Loan*, 110 F.R.D. at 562. The more recent *Model Rules of Professional Conduct* avoid any ambiguity by explicitly authorizing disclosure by the

to the attorney-client relationship, as some have forcefully maintained,¹²⁷ it is possible to handle the problem without prohibiting third-party suits against attorneys. For example, the court could determine that confidential information is necessary to the attorney's defense before permitting its disclosure.¹²⁸ No other differences between the tasks performed by accountants and attorneys can even plausibly justify separate treatment of the two professions. There may be sound normative reasons for retaining the privity rule for attorneys, and the effect of third-party litigation on the attorney-client relationship may be nothing but pernicious, but as a descriptive matter, if there is doctrinal pressure on a court to depart from the privity rule with respect to attorneys, problems such as confidentiality are unlikely to provide a powerful counterweight.

Jurisdictions that rely, in whole or in part, on enterprise liability arguments to justify expanded accountants' liability to third parties will find it even more difficult to justify a separate liability standard for attorneys. To whatever extent that enterprise liability arguments are persuasive,¹²⁹ they apply equally to accountants and attorneys. If courts believe that accountants will be deterred from wrongdoing by the prospect of third-party liability, there is no reason for them not to believe the same of attorneys.¹³⁰ Similarly, if courts believe that the availability of professional insurance makes accountants good risk-spreaders, the same is true about attorneys, who are no less or more able to obtain insurance than accountants. Finally, if it is better to impose liability on negligent accountants than on reasonably relying third parties, there is no reason within the enterprise-liability framework for reaching a different conclusion when attorneys are involved.

2. Changing Conceptions of Professional Roles

Outside the enterprise-liability framework, subjecting attorneys to third-party liability is in troublesome tension with the attorney's ethical obligation "to represent his client zealously within the bounds of the law,"¹³¹ and may seriously distort the traditional attorney-client relationship. How, one might

attorney in defense of claims brought by third parties. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(b)(2) (1989); cf. AICPA CODE OF PROFESSIONAL CONDUCT Rule 301 (1988) (permitting accountants to reveal confidential client information when necessary to "respond[] to any inquiry made by a recognized investigative or disciplinary body," but making no mention of defense against lawsuits).

¹²⁷ See *Crossland Sav. v. Rockwood Ins.*, 700 F. Supp. 1274, 1282-83 (S.D.N.Y. 1988); Note, *supra* note 2, at 21-23.

¹²⁸ See *First Fed. Sav. & Loan*, 110 F.R.D. at 566-68.

¹²⁹ That extent, in our view, is very small. See *Lawson & Olson*, *supra* note 13, at 36, 71-72.

¹³⁰ See Note, *supra* note 35, at 130-31.

¹³¹ MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-1 (1986).

ask, can an attorney give single-minded devotion to the interests of his client if he must also guard against liability to third parties?¹³² This traditional view of the attorney as the faithful servant of the client,¹³³ within very broad legal and ethical boundaries, is the key both to understanding the difference in treatment currently afforded accountants and attorneys in third-party litigation and to predicting future trends in attorney liability.

Accountants, no less than attorneys, work for clients. First parties, not third parties, pay accountants' fees. But while the contractual basis of accountants' relationships with their clients may have nourished the privity rule in times past,¹³⁴ it does not impress modern courts to the same extent. As noted earlier,¹³⁵ many of these courts declare explicitly—and we suspect many more hold tacitly—that the widespread fact, or even perception, of third-party reliance on accountants is itself sufficient justification for discarding privity rules in negligent misrepresentation cases. The decision of the California Court of Appeal in *International Mortgage Co. v. John P. Butler Accountancy Corp.*¹³⁶ is illustrative. In adopting the foreseeability standard for third-party accountant liability, the court maintained that outside audits are “imbued with considerations of public trust, for the accountant must well realize the finished product . . . will be relied upon by creditors, stockholders, investors, lenders or anyone else involved in the financial concerns of the audited client.”¹³⁷ In the same vein, the New Jersey Supreme Court in *H. Rosenblum, Inc. v. Adler*,¹³⁸ suggested that “[t]he auditor's function has expanded from that of a watchdog for management to an independent evaluator of the adequacy and fairness of financial statements issued by management to stockholders, creditors, and others.”¹³⁹ Echoing the same litany in *Spherex, Inc. v. Alexander Grant & Co.*,¹⁴⁰ the New Hampshire Supreme Court declared that the accountant today ““must accept the burdens of legal responsibility that go along with the benefits derived from his important role in the modern business

¹³² See *Crossland Savings*, 700 F. Supp. at 1282–83.

¹³³ See *supra* text following note 8.

¹³⁴ We suspect, though we cannot prove, that the true origin of the privity rule for accountants lies in the ideology of contract (and we do not use the phrase disparagingly) rather than in the policy concerns emphasized by Judge Cardozo in *Ultramares*. See *supra* notes 42–44. Judge Cardozo's oft-quoted opinion explained that the imposition of a noncontractual duty could “expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class” for “a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries.” *Id.* at 179, 174 N.E. at 444.

¹³⁵ See *supra* text accompanying note 107.

¹³⁶ 177 Cal. App. 3d 806, 223 Cal. Rptr. 218 (1986).

¹³⁷ *Id.* at 817, 223 Cal. Rptr. at 224.

¹³⁸ 93 N.J. 324, 461 A.2d 138 (1983).

¹³⁹ *Id.* at 346, 461 A.2d at 149.

¹⁴⁰ 122 N.H. 898, 451 A.2d 1308 (1982).

community.”¹⁴¹ That is merely a polite way of saying that accountants must be liable to third parties simply because third parties rely on them. Similarly, the North Carolina Supreme Court in *Raritan River Steel Co. v. Cherry, Bekaert & Holland*¹⁴² denigrated the privity rule for accountants because it is inadequate for the “central role independent accountants play in the financial world.”¹⁴³ The court reasoned that “accountants’ audit opinions are increasingly relied upon by the investing and lending public in making financial decisions Because of this heavy public reliance on audited financial information we believe an approach that protects [relying third parties] is desirable.”¹⁴⁴

The unmistakable message of these cases is that, as far as the legal system is concerned, the accountant serves a far broader clientele than the audit contract might suggest. Indeed, in this world view, the accountant is less a servant of the paying client than of these other constituencies, which rely on the accountant to keep the nominal client honest. It is not surprising that courts animated by this vision of the accountant find the privity rule unattractive, or even incomprehensible.

In contrast to this vision, the familiar image of the attorney as the paying client’s faithful servant still seems to loom large in this area of the law and elsewhere. Courts do not speak of the attorney’s primary responsibility to nonclients in terms comparable to the above-quoted language concerning accountants.¹⁴⁵ This may explain why courts apply different standards of third-party liability to the two professions. Third-party accountant liability is deemed appropriate because courts consider it reasonable for the public to expect accountants to serve nonclients. But it is considered to be quite another matter for the public to expect attorneys to divide their loyalties between clients and

¹⁴¹ 122 N.H. at 904, 451 A.2d at 1312 (quoting Mess, *Accountants and the Common Law: Liability to Third Parties*, 52 NOTRE DAME LAW. 838, 856 (1977)).

¹⁴² 322 N.C. 200, 367 S.E.2d 609 (1988).

¹⁴³ *Id.* at 211, 367 S.E.2d at 615.

¹⁴⁴ *Id.*; see also *First Fla. Bank v. Max Mitchell & Co.*, 558 So. 2d 9, 15 (Fla. 1990) (“Because of the heavy reliance upon audited financial statements in the contemporary financial world, we believe permitting recovery only from those in privity or near privity is unduly restrictive.”); *Law Offices of Lawrence J. Stockler v. Rose*, 436 N.W.2d 70, 82, 174 Mich. App. 14, 36 (1989) (adopting the *Restatement* test “[f]or the reasons stated in *Raritan River Steel Co.*”); *Haddon View Inv. Co. v. Coopers & Lybrand*, 70 Ohio St. 2d 154, 157, 436 N.E.2d 212, 214-15 (1982) (the privity rule “ignores the modern verity that accountants make reports on which people other than their clients foreseeably rely This being the case, the accountant’s duty . . . extends to any third person to whom they understand the reports will be shown for business purposes.”).

¹⁴⁵ Admittedly, they do not speak of the attorney’s primary responsibility to his client either. As we have previously noted, they do not really say much of anything. In this instance, however, the silence alone is significant, as it is reasonable to assume that the traditional conception of the lawyer’s role retains vitality unless a court indicates otherwise.

nonclients. Thus, as long as courts hold fast to the image of the attorney as the client's loyal fiduciary, it is plausible to expect attorneys to continue to receive relatively favorable treatment in third-party lawsuits.

3. *Enter the SEC*

The likely durability of the traditional conception of the lawyer's role is a subject best left to experts on the legal profession. There is, however, a series of events from the recent past concerning the liability of attorneys under the federal securities laws that is particularly instructive.

In 1972, the Securities and Exchange Commission (SEC) filed a complaint in district court alleging numerous violations of the federal securities laws concerning a merger between National Student Marketing Corporation and Interstate National Corporation (NSMC).¹⁴⁶ Among the many defendants named in the complaint were two prominent law firms and several of their partners.¹⁴⁷ The complaint accused the lawyers of aiding and abetting a fraudulent scheme by failing to insist that certain last-minute adjustments to NSMC's financial statements be disclosed to shareholders of the two merging companies and public investors. In addition, the SEC charged that the lawyers should have demanded that shareholders be resolicited after dissemination of the corrected financial statements.¹⁴⁸ The most noteworthy portion of the complaint alleged:

As part of the fraudulent scheme [the lawyers] failed to refuse to issue their opinions [giving the go-ahead to consummation of the merger] and failed to insist that the financial statements be revised and shareholders be resolicited, and failing that, to cease representing their respective clients and, under the circumstances, notify the plaintiff Commission concerning the misleading nature of the nine month financial statements.¹⁴⁹

The claim, in other words, was that the securities laws required the lawyers to "rat" on their clients to the SEC.¹⁵⁰

¹⁴⁶ See *SEC v. National Student Mktg. Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 93,360 (Feb. 3, 1972) [hereinafter *NSMC*]. The literature on *NSMC* is voluminous but essentially irrelevant to this discussion. Those curious about the details of the case can consult the District Court opinion. *NSMC*, 457 F. Supp. 682 (D.D.C. 1978).

¹⁴⁷ See *NSMC* at ¶¶ 17-18, 24-26.

¹⁴⁸ See *id.* at ¶ 48.

¹⁴⁹ *Id.* at ¶ 48(j).

¹⁵⁰ The case's final resolution was anticlimactic. The district court agreed in dicta with the SEC's finding of liability, but refused to issue an injunction against the lawyers. *NSMC*, 457 F. Supp. at 712-17.

Where could the Commission have gotten that notion? Public statements made by Commission officials shortly after the filing of the NSMC complaint suggest one possible answer. On January 24, 1974, SEC Commissioner A.A. Sommer, Jr., delivered a speech to the Banking, Corporation, and Business Law Section of the New York State Bar Association.¹⁵¹ The following excerpts from the speech convey its flavor:

We are consistently reminded that historically the attorney has been an advocate, that his professional ethics have over the years defined his function in those terms, that such a role includes unremitting loyalty to the interests of his client (short of engaging in or countenancing fraud)

I would suggest that the security bar's *conception* of its role too sharply contrasts with the *reality* of its role in the securities process to escape notice and attention—and in such situations the reality eventually prevails

We live in the age of the consumer. All of the old articles of faith which frustrated him in efforts to achieve equity have fallen or are falling This pervading judicial and legislative concern for the interests of the consumer which has for forty years been present in large measure in the securities field (the securities laws may have been the first federal consumer legislation) is affecting and will affect increasingly the securities field—and those involved in it.

Consequently, I would suggest that all the old verities and truisms about attorneys and their roles are in question and in jeopardy—and, unless you are ineradicably dedicated to the preservation of the past, that is not all bad.

I would suggest that in securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a manner more akin to that of the auditor than to that of the advocate. This means . . . he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence.¹⁵²

It was not difficult to read these remarks as a declaration that securities lawyers who prepare disclosure documents should owe a duty of care to the investing public¹⁵³—especially because the speech came on the heels of strong dicta from the Second Circuit Court of Appeals suggesting much the same thing in the context of attorneys' opinions concerning exemptions from registration requirements.¹⁵⁴ Significantly, if one believes in such a public

¹⁵¹ See Sommer, *The Emerging Responsibilities of the Securities Lawyer*, Fed. Sec. L. Rep. (CCH) ¶ 79,631 (1974).

¹⁵² *Id.*

¹⁵³ See Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U. L. REV. 437, 437–40 (1974).

¹⁵⁴ See *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 542 (2d Cir. 1973):

duty, it is a small logical step to the proposition that attorneys must police their nominal clients on behalf of the SEC, the public's self-proclaimed representative.

In 1975, these implications were made explicit in an article by Theodore Sonde, then Associate Director of the Commission's Division of Enforcement.¹⁵⁵ In response to some critics who objected to the view of lawyers as public servants, which they saw implicit in the Commission's actions and Commissioner Sommer's speech, Sonde did not deny that the Commission held such a view.¹⁵⁶ He denied only that this claimed public duty would ever conflict with lawyers' private duties to their clients or that the Commission would in practice prosecute attorneys for mere negligence.¹⁵⁷ More significantly, in the course of drawing a distinction between the lawyer's functions as advocate and adviser, with the aim of suggesting that the traditional role conception inadequately described the latter, Sonde cited a contemporaneous Commission release concerning the public duties of accountants in a manner that made unmistakably clear his view that securities lawyers involved in the disclosure process serve the investing public as much or more than their paying clients:

In the distribution of unregistered securities, the preparation of an opinion letter is too essential and the reliance of the public too high to permit due diligence to be cast aside in the name of convenience. The public trust demands more of its legal advisers than "customary" activities which prove to be careless.

One scholar, writing in 1977, saw this dicta as part of a developing doctrine in the courts. "It appears . . . that the courts, sometimes prodded by the SEC, have begun to recognize that the duty of a lawyer runs . . . at least in certain circumstances to the public, [and] that such duty includes a standard of due care." Frank, *supra* note 28, at 350. We think that this significantly overstated the case even in 1977, though of course we now have the benefit of hindsight.

¹⁵⁵ Sonde, *Professional Responsibility—A New Responsibility or the Old Gospel?*, 24 EMORY L.J. 827 (1975).

¹⁵⁶ Indeed, he all but endorsed the view that attorneys owe a duty of care to the investing public when preparing disclosure documents:

Negligence, the absence of reasonable care, is the criterion that governs most if not all other aspects of liability for human behavior, and it is difficult to see why lawyers and accountants should be provided with special rules. After all, lawyers and accountants are liable to their immediate clients and others for negligence in actions brought against them for malpractice. It seems that the only real question involved is *not* whether professionals should properly be held accountable for their negligence, but rather, given the potential liability that exists in this area, whether the public interest is furthered by exposing these professionals to that form of liability.

Id. at 851-52 (footnote omitted).

¹⁵⁷ See *id.* at 847-51.

"Professionals involved in the disclosure process are in a very real sense representatives of the investing public served by the Commission, and, as a result, their dealings with the Commission and its staff [and implicitly the investing public] must be permeated with candor and full disclosure. It cannot resemble an adversary relationship more appropriate to litigants in court, because the Commission [as well as the investing public] is not an adverse party in this context."¹⁵⁸

These were not the first such statements by Commission officials,¹⁵⁹ but they were the loudest.

The bar did not react kindly to these comments. On August 12, 1975, the American Bar Association's House of Delegates adopted a resolution and a committee report specifically responding to the SEC's position that securities lawyers must police their clients' compliance with federal disclosure laws on behalf of the public.¹⁶⁰ The resolution insisted that "[t]he confidentiality of lawyer-client consultations and advice and the fiduciary loyalty of the lawyer to the client . . . are vital to the basic function of the lawyer as legal counselor."¹⁶¹ The ABA also noted that "a lawyer cannot, consistently with his essential role as legal adviser, be regarded as a source of information concerning possible wrong-doing by clients."¹⁶² The accompanying report of

¹⁵⁸ *Id.* at 862 (quoting *In re Arthur Andersen & Co.*, Accounting Release No. 157, 4 SEC DOCKET 547, 550 (July 8, 1974) (bracketed material in original)). Sonde did not suggest that the Commission or the investing public split the lawyer's fee with the nominal client. Cf. R. JENNINGS & H. MARSH, *SECURITIES REGULATION: CASES AND MATERIALS* 1237 (6th ed. 1987) ("Professor Morgan Shipman [of the Ohio State University College of Law] has asserted that the securities lawyer doesn't really have any client, but is the attorney to 'the situation.' This has prompted one lawyer to inquire whether he should send his bill to 'the situation'; and if he did, would the situation pay it?") (footnote omitted). In fairness to Professor Shipman, it should be noted that he clarified his comments by observing that "[n]one of this is to say that corporate counsel represents the public at large." Shipman, *The Need for SEC Rulemaking Concerning the Duties and Civil Liabilities of Attorneys*, 30 BUS. LAW. 34, 36 (March 1975).

¹⁵⁹ See Lowenfels, *Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties*, 74 COLUM. L. REV. 412, 425-27 (1974) (collecting pre-NSMC comments on the legal profession by SEC personnel).

¹⁶⁰ See *Statement of Policy Adopted by American Bar Association Regarding Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered by the Securities and Exchange Commission*, 31 BUS. LAW. 543 (1975).

¹⁶¹ *Id.* at 544.

¹⁶² *Id.*

the Committee on Counsel Responsibility and Liability of the Section of Corporation, Banking, and Business Law (CCR) similarly affirmed the "basic principle that the lawyer's role is essentially that of counselor to his client."¹⁶³ The CCR also maintained that the attorney-client relationship

is undermined to the extent that client communications with lawyers are made with the risk that the lawyer will, if not satisfied with the client's response to his advice or if concerned over his own potential personal liabilities, report possible deficiencies to third parties. Accordingly, it has long been recognized by the Code of Professional Responsibility . . . that only in the clearest cases of illegal or fraudulent activities by a client in the course of the lawyer's representation should the lawyer be called upon or permitted to take such action.¹⁶⁴

This clash of role perceptions between the American Bar Association and the SEC threatened to escalate into total war when, shortly thereafter, the SEC began seriously wielding its Rule 2(e).¹⁶⁵ Rule 2(e), which many practitioners and observers viewed as heavy handed and potentially dangerous,¹⁶⁶ purports to authorize the Commission to regulate persons who practice before it.¹⁶⁷ The

[T]he lawyer has neither the obligation nor the right to make disclosure when any reasonable doubt exists concerning the client's obligation of disclosure, i.e., the client's failure to meet his obligation is not clearly established, except to the extent that the lawyer should consider appropriate action, as required or permitted by the [Code of Professional Responsibility], in cases where the lawyer's opinion is expected to be relied on by third parties and the opinion is discovered to be not correct, whether because it is based on erroneous information or otherwise.

Id. at 545.

¹⁶³ *Id.* at 546.

¹⁶⁴ *Id.* at 547.

¹⁶⁵ 17 C.F.R. § 201.2(e) (1990).

¹⁶⁶ See, e.g., Best, *In Opposition to Rule 2(e) Proceedings*, 36 BUS. LAW. 1815, 1815-17 (1981); Krane, *The Attorney Unshackled: SEC Rule 2(e) Violates Clients' Sixth Amendment Right to Counsel*, 57 NOTRE DAME LAW. 50, 89-90 (1981); Marsh, *Rule 2(e) Proceedings*, 35 BUS. LAW. 987, 987-93 (1980); Wheat, *The Impact of SEC Professional Responsibility Standards*, 34 BUS. LAW. 969, 969-72 (1979).

¹⁶⁷ 17 C.F.R. § 201.2(e)(1) states:

The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice of and opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws . . . or the rules and regulations thereunder.

clash, however, ended with a whimper when the SEC indicated that it would define the ethical standards for its practitioners in very traditional terms¹⁶⁸ and later seemingly abandoned altogether the enterprise of regulating the legal profession.¹⁶⁹

4. *The Lessons To Be Learned*

One can draw several different lessons from the foregoing episode. An optimistic attorney could point to the ABA's quick and firm reaffirmation of the traditional conception of the lawyer's role and the SEC's eventual retreat from its contrary position as signs of the strong vitality of the traditional conception. Indeed, this forceful response from one of the legal profession's most important self-regulatory bodies stands in sharp contrast to the AICPA's hearty embrace of the notion that accountants are, notwithstanding the terms of their employment contracts, servants of a broader public interest.¹⁷⁰ Accountants, the optimistic attorney might conclude, have merely gotten exactly what they asked for.

We are not optimists. Instead, we see strong evidence of the fragility of the traditional concept of the attorney's role in the fact that a major federal regulatory agency seriously believed, for nine years, that it could get away with such a large scale redefinition of the lawyer's responsibilities. If that is indeed the appropriate lesson to draw, then the line between the third-party liability of attorneys and accountants may be much narrower than a simple nose count of jurisdictions presently suggests. There is no obvious reason why courts should be expected to be more solicitous of lawyers' interests than is the SEC.

In view of the evident connection between role conception and tort liability, lawyers might want to think twice before trying to improve their images with syrupy talk about their service and obligations to the public. The public might believe them.

¹⁶⁸ See *In re Carter and Johnson*, Exchange Act Release No. 17,597, 22 SEC DOCKET 292 (Feb. 28, 1981).

¹⁶⁹ On September 21, 1981, the Commission requested public comment on a proposed standard of conduct for professionals, see *Standard of Conduct Constituting Unethical or Improper Professional Practice Before the Commission*, Securities Act Release No. 6344, 23 SEC DOCKET 826 (1981), but it never acted on the proposal.

¹⁷⁰ See *supra* text accompanying note 110.

